



Texas Papers on Latin America

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Market Opportunities for Pay Television Services in Chile: A Strategic Assessment

by David Wells, 1997

A NOTE ON SOURCES

Because my intent for this paper is to strategically analyze the current opportunities for entering the pay-television (pay-TV) market in Chile, I have utilized the most recent and cogent sources available to me in the Benson Latin American Collection, UT-LANIC, and the Perry Castañeda Library, each of the University of Texas at Austin. Sources include, but are not limited to, government publications, industry-related websites, trade papers, scholarly journals, and reference books. Where possible I support articles taken from popular sources such as industry reports, newspapers and magazines with articles from more scholarly sources such as academic journals and books. The Chilean pay-TV market is still in its infancy and trade papers such as the entertainment industry newspaper *Variety*, and the magazines *Cablevision* and *Multichannel News*, tend to provide the most timely information on both the Chilean and Latin American pay-television markets. Business reference sources such as the newsletter *Business in Latin America*, published by the Economist Intelligence Unit, provide reliable, respected and time-relevant, business and country statistics and are also used to a great degree in the report.

INTRODUCTION

Television first emerged in postwar Latin America as a status symbol of the rich. By the 1970's it had become a staple of the middle class; and by 1990, the urban poor had access to it in many Latin American countries. Lynn H. Roberts, a journalist writing for *U.S./Latin Trade* in 1995 stated, "Television, the world's most democratic form of entertainment, is changing life in Latin America." Local broadcast options have snowballed, and pay-TV, where viewers have more choices, is booming. Many options exist, and more arrive as technology develops and infrastructure is provided, so much so that networks are expecting a shakeout, a consolidation and a leveling-off of options. As United States pay-TV firms look to bring franchises abroad, Latin America is proving to be market-ready for some cable programmers and operators. However, the pay-TV markets in Argentina, Brazil and Mexico are already near, or have surpassed, saturation, thus this paper recommends that firms looking to get a head start on the competition should consider the comparatively mature, and safe Chilean pay-TV market.

The paper has three main sections. The first offers a brief explanation of the pay-TV industry as it pertains to this paper. The second discusses Chile's market potential relative to the Latin American region as a whole. The third analyzes the strengths and weaknesses of the national market in Chile, covering the environmental factors of political and economic risk, infrastructure, education, and labor issues, as well as programming and advertising issues. A conclusion follows.

The Pay-TV Industry

For the purposes of this paper, the pay-TV industry is loosely defined as a media service industry providing either entertainment programming or operations through cable or satellite dishes. I chose this loose definition because although the cable television industry is relatively mature, the direct broadcast satellite industry is still in a nascent period, and because there is a rapidly growing synergy among telecommunications projects that has yet to receive an industry standard delineation. It must also be noted that Chile, although it is wired for cable in some areas and has a fairly mature market, still has market potential for a mixture of telecommunications options such as direct-to-home (DTH) television, fiber optic cabling, telephony and many others-thus a loose definition fits the market.

Before I discuss the national market for pay-TV in Chile, a brief explanation of the industry as it affects Chile is necessary. To understand what it is happening with new cable and satellite technologies requires far

more space than is possible to include in this report. However, any understanding begins with an awareness of the basic elements at work.

At the heart of the pay-TV market in Chile is the marriage of cable television and satellite communication. These two elements have now combined with computers and dozens of new home video and telephone products to produce the communications revolution that is sweeping Latin America.

For this paper, I have broken the industry down into generalized building blocks. The first distinction to be made is between cable operators and cable programmers: a cable operator runs the service, and a cable programmer provides the content.

Pay-TV companies offer a multiplicity of special-program channels as part of their basic service. These channels are called networks, because just like the U.S. stations, ABC, CBS, NBC and Fox, they can be received simultaneously across a country or region. Networks generally come in packaged form, and a basic cable package may have 20-25 channels of this type. (As the number of channels increases with different types of programming, so does the cost). A second type of network is the premium channel, such as HBO, Showtime and Cinemax. Subscribers to these services pay a fee above the basic charge, for these services. In addition to the premium channels there are even more expensive pay-per-view (PPV) channels, which tend to carry programs that are not yet available for premium channels or networks. Subscribers pay a one-time fee to watch these programs.

A new technology, still in its infancy but growing at a rapid rate is direct-to-home television. DTH-TV involves a small satellite dish called a direct broadcast satellite (DBS), and a decoder box. Depending on the technology of the decoder box the subscriber can receive a large number (100+) of networks, premium channels and PPV, as well as digital audio music signals through the dish.

DTH-TV is not only changing the way people watch television, it is changing the way cable operators function. It is a boon for areas plagued by infrastructure problems-with little more than an satellite dish, a decoder box, and a power source, DTH-TV can beam hundreds of channels into a home, whether it be in metropolitan Santiago, the high-points of the Andes, or in the baked sand of the Atacama desert.

Another high-stakes issue in the Latin American market is whether telephone and telecommunication companies will be allowed to move into cable television services, and vice versa. In Argentina, the largest per capita cable television market in Latin America (Brazil has the largest market), there are as many TV cables as telephone lines, and the next step for industry is to venture into data-transmission and the Internet. Cable TV programmers can then use either television or telephone lines to act as Internet providers and at the same time can advertise their programming schedules and the like.

Due to deregulation, competition in Chile is fierce. Cable's future will thus involve expanding existing operations while providing new information services to customers, such as those mentioned above. To accomplish this multiple system operators (MSOs) are also experimenting with digital video compression, multiplexing, smart TV and other interactive technologies. Multiplexing involves providing a single program service on several different channels, such as HBO, HBO2, and HBO3. All run the same programming, but at different starting times. DTH uses this technology to a successful degree.

The Pay-TV Market in Latin America

The key to success in the pay-TV industry is differentiation, and to differentiate itself in the Chilean marketplace a firm needs to establish an exclusive identity. Entering the Latin American pay-TV market is prudent only if a firm recognizes that the region is not one single, homogenous market beginning at the Rio Grande river in Mexico and extending South to Tierra del Fuego in Chile. Latin American countries and their attached markets contain an enormous number of differing characteristics. Each country has difficulties and opportunities that are distinct; especially in the pay-TV sphere. The most important difference is that there are Latin American markets, such as Chile, where systems do not enjoy the type of geographic monopoly seen in the U.S. Thus far, this is something international programmers have chosen to ignore or have failed to perceive.

However, geographic exclusivity is not the only key to success in pay-TV markets, and this section offers evidence that Chile is a comparatively strong pay-TV market in regards to the rest of Latin America for economic, technical, and competitive reasons.

Economically, Chile is arguably the safest country in Latin America to start business ventures. The Chilean economy, like its Mercosur partner markets,

has done well in recent years, causing it to be regarded as the jewel of Latin American markets by international investors.

Although pay-TV penetration is still low in Latin America, ad revenues topped US\$15 billion in 1996, and the privatization of channels, easing of restrictions on cable and satellite services, and increasing protection for intellectual property are providing an hospitable, and profitable atmosphere of growth. An increasing number of channels means a higher demand for programs which translates into opportunities for U.S. producers and distributors to generate additional revenue by forming joint ventures with their Latin American counterparts.

But why enter the market in Chile, if the market is so strong elsewhere why not go pan-regional to start? Because, with at least 30 U.S. channels in play, and at least that many U.S. and local networks maneuvering to join the fray, many firms are finding that pay-TV is not a short-term, fast-buck market. Distribution, and differentiation are the key to success, but many cable boxes are still limited to 30 channels. Despite the potential for a large ad market, there is some inertia there, and pay-TV firms must face, maturing, but unpredictable economies. Pay-TV firms looking to enter the Latin American market can expect to have to convince skeptical advertisers by spending big money on viewer research, and to set break-even targets for anywhere from 3 years to 5 years or more (the 3 year targets have been called best case-scenarios).

Industry sources agree that Latin America is about 15 to 20 years behind the U.S. market and has much lower penetration, and bigger programmers are hogging the revenue trough. Programmers with several networks owned by parent companies such as Time Warner and Sony took in returns in excess of US\$50 million to US\$90 million in 1996. Most channels scrape by on less than US\$10 million a piece. With operating costs in start-up years typically surpassing US\$10 million, most pay-TV firms can expect to start, and stay, in the red for a number of years.

Despite the factors mentioned above, or perhaps more clearly, due to the factors mentioned above, the best reason for entering the Chilean market is this-a market shakeout is expected for Latin America. The hardest hit markets will be those with the most competition, thus a firm in Chile is more likely to weather the shakeout than one in a market like Argentina or Brazil. In addition, the overall economy and audience of Chile is comparatively secure, and is thus a firm focused on that region is more likely to survive a shakeout and be able to act on any lucrative possibilities created by a shakeout.

Investing in pay-TV in Latin America means banking on future growth, and Chile is poised for it. In 1996 Chile had a population of 14.6 million, divided into 4 million households, with 3.5 million households having televisions. There were 500,000 pay-TV subscribers (cable, wireless, and DTH-TV) and the TV ad market was US\$142 million. In 1994 Chile saw two pay-TV deals happen for US\$64 million. In 1995 the number of deals expanded to three for US\$148 million. The room for growth is still there, and Chile also has a strong market for related entertainment options, which are signs that the market for entertainment services is growing with the success of the economy. For instance, there is an original production movie and television business in Chile, and despite rising ticket costs and decreasing box office figures, Chile is one of Latin America's major film markets. The 1995 box office figures for Chile were \$US 18 million, with an attendance figure of 6 million people at 126 screens with a top ticket price of \$6.10.

There is also room for growth in the pan-regional advertising market. Convincing a company to advertise on cable television in Latin America a few years ago was a difficult sell. The number of cable subscribers-- 9.8 million, or 13 percent of available households-- was low. Service by local cable operators was poor, technical difficulties were common, the range of programming was limited, and the economic crisis spawned by the peso devaluation in Mexico had hurt the spending power of many Latin Americans. This is no longer the case. Cable operators are busy investing in new technologies. Customer service is seeing a turnaround, and programming choices are growing. Half a dozen new cable channels have been launched since the middle of 1996, including Nickelodeon, Discovery Kids, Fox Kids, and CNN en Español. One startling example of growth is this, in 1993, *Variety* published a Latin America satellite fact sheet which showed 25 satellite channels operating in Latin American markets. By 1994 there were 56 channels; by 1996, 74.

Despite those numbers, cable penetration, or the actual number of households those channels legally reach is still low-- 10.7 million, or about 13.3 percent of available households. But advertising growth rates are a positive sign that interest in cable and other related media is growing. For instance, in 1995 Chileans spent US\$1.1 billion on advertising, 9.5 percent more than in 1994. Department stores were the biggest spenders, followed by the telecommunications industry, car companies, the government, soft drinks and beer. Companies spent US\$603 million of that pie, using 46.3 percent of spending on television ads. It should be noted that although companies are spending more on advertisements, the business is still small

compared with more developed countries. But on a pan-regional level, international advertising agencies are following their clients to Latin America looking to service current clients who are investing in the region as well as local companies already under operation, despite the fact that a pan-regional advertising strategy is still not completely feasible because of diverging regulations and localized media. However, as the pay-TV industry becomes more competitive Latin America's advertising industry will continue to see a boom. The region already leads global markets in spending on GDP (1.3 percent), and an average annual growth of 13.4 percent should be seen over the next three years.

The economic recovery of many countries, combined with new technologies such as DTH-TV has started a turnaround in the Latin American pay-TV business. DTH-TV has raised the stakes in the pay-TV game, forcing cable operators to improve customer service and encouraging U.S. cable networks to introduce new channels. A U.S.-based research company, the Strategis Group, estimates that 44 million homes, or 30 percent of available Latin American households will be reached by cable and satellite industries by 2005. That should translate into US\$20 billion in annual revenue, versus US \$3 billion in 1995. However, the proliferation of cable channels coming into the Latin American market increases the propensity for a shakeout.

Technically, Chile is prepared for modern telecommunications options. One of the most likely options for the near-term success of the Chilean pay-TV market is the aforementioned DTH-TV market. Because of its flexibility, DTH-TV has tremendous potential for Chile, as well as the rest of Latin America. It is expected to help grow the pay-TV industry as a whole, and by the year 2000, the DTH-TV market should be worth an expected US\$5.8 billion. The only current barrier to the formats success is the price to the user. The cost of a decoder box can range from US\$400 to \$995, depending on the country and its tariff structure, and depending on the package of channels and services, the monthly rate can range from US\$20 to US\$50.

Competitively, Chile is a mature, but less-saturated market than the three biggest Latin American markets, Mexico, Brazil and Argentina. The medium of television, seen as a business unto itself, is rapidly changing Latin America. United States and European cable broadcasters are wiring up, or beaming to, millions of homes. The foreign-produced cartoons, sports events, documentaries and movies as well as the Latin American produced telenovelas are taking over Latin American entertainment markets, but in Chile, a pay-TV firm would be up against less competition than the three aforementioned countries.

Products like DTH-TV, digital programming, and other emerging technologies, are making the cable-television industry an exceedingly competitive, global game. A company can be headquartered anywhere, it just needs a service or possibly sales department in the host country.

For example, one of the most watched networks in Latin America, CBS's Telenoticias, began when a global coalition of news providers savvy to the region saw a market for a cable news channel. A joint venture was started in 1994 between Reuter's (United Kingdom), Telemundo (USA), Antena 3 (Argentina), and Artear. However, the new network soon found itself in financial straits, and none of the partners wanted to open up their coffers for further investment. Westinghouse/CBS, seeing a potential profit, dug into its deep pockets, taking the network off of the joint venture's hands in June 1996. It now has 10 million viewers, a large customer base, with big families in a population dominated by the young. Add sales are up 300 percent since it was bought, and a Portuguese-language network will soon start for Brazil.

Two other major competitors in the Latin American pay-TV game are competing for the DTH-TV market: Galaxy Latin America, and Sky Entertainment Services Latin America. Galaxy is a partnership between DirecTV International (a unit of US-based Hughes Electronics), the Cisneros Group (Venezuela), TVA (Brazil), and MVS Multivisión (Mexico). Last July the company started service to Brazil and Venezuela, later expanding into Mexico, Ecuador, Panama, Costa Rica, Trinidad and Tobago, and Barbados. By adding Chile, Colombia and Argentina within the middle of 1997, Galaxy will cover 90 percent of Latin America. The partnership has invested between US\$500 to \$550 million in the venture; it hopes to break even within three and a half years. Galaxy currently charges between \$300 and \$599 for a decoder box and between \$22 and \$40 for monthly rates. As new technologies are developed and DTH-TV becomes more commonplace, the cost is predicted to drop-to prices comparable to VCRs (\$200) within 5 years.

Sky Entertainment Services Latin America is a partnership consisting of Organizações Globo (Brazil), Grupo Televisa (Mexico), News Corp. (Rupert Murdoch), and Tele-Communications International (USA). Sky began service in Brazil last October and in Mexico last December. It plans to add Chile, Argentina, and Colombia in the first half of 1997, and the balance of the region shortly thereafter. This cost \$540 million (\$200 million raised through a debt offering for the Brazilian launch). Sky charges from \$450 to \$995 for a decoder box and \$45 to \$50 in monthly fees.

Operators contend that the high cost of launching DTH-TV in Latin America will pay off, even if only the well-off can afford it. But, DTH-TV providers do feel the threat of an oncoming shakeout. As the pay-TV business matures, it becomes less profitable; however, with DTH-TV the more the market is penetrated the higher the margins. Adding customers comes at a marginal cost. DTH-TV proponents argue that cable operators will have to move to digital systems and provide stronger service to compete with the quality of DTH-TV.

Direct-broadcast satellite service DirecTV received approval to begin operations in Chile by that country's office of the Subsecretary of Telecommunications of the Transportation and Telecommunications Ministry in December of 1996. The government granted a license to a local operating company, VTR Galaxy Chile (a local operating company of Galaxy Latin America), to receive and distribute DirecTV. DirecTV is the first DTH home entertainment service in the country. Service was expected to start in early 1997, with over 100 channels from the U.S., Europe, Asia and Latin America; service actually began on 18 March 1997. There are more than 50 video channels, 33 audio channels, and 2000 hours of programming from Latin America, Europe, Asia, and the US.

The following section takes a broader look at the positive and negative points of the overall Chilean market.

The Chilean Pay-TV Market

This section is divided into five subsections. The first offers a brief and general history of the pay-TV market in Chile, and the other four cover environmental factors: political risk, economic risk, infrastructure, education, labor and competition issues, as well as programming and advertising issues. These issues are important to consider because in order to stay competitive in Chile pay-TV programmers and operators will have to be sensitive to Chile's economic, political and cultural environment. The Chilean pay-TV market must be seen as a long-term investment. As the market crowds with newcomers, as well as new technology, operators and programmers will have to be agile to escape to the market's volatility.

Firms that do not have the agility to escape the market's volatility may find it difficult to enter other markets. If a firm promises a certain type of service, it must be careful to deliver what is promised, otherwise its credibility might be damaged and the likelihood of impairment to the firm's chances to gain entry in other Latin American markets will increase. This is

a particular problem in Latin America, because there is little or no chance for heavy penetration both in Chile and in Latin America as a whole, thus firms must think in terms of diverse products for a comparatively small base of customers.

A Brief History

The Chilean television market was created in the early 1960s. It was owned and operated either by universities or by the government. There were four channels. Channel 11 was run by the University of Chile; channel 14 by the Catholic University of Santiago; channel 5 by the Catholic University of Valparaíso; and channel 7, the National Channel, was owned by the government. The university-based stations gradually became independent, but the National Channel remained under the careful watch of the government. After the 1973 coup which put Augusto Pinochet in power, all television came under government control. University presidents, appointed as overseers by the government, controlled the university channels. Like everything in Chile at that time, television changed in the years following the coup. From 1962 to 1973 television had a small audience; few people owned a set and programming was in black and white. Television's impact was negligible at best. However, the Pinochet regime molded public opinion by disseminating its values, ideology and propaganda through television, and as a result television became Chile's national mass medium. Today, more than 90 percent of Chilean homes have a television set. Programming is of high quality and television is a more common source of information than the radio, and even though Chile is a relatively small market, it is a prime target for international investors who see it as one of the best low-risk growth areas of Latin America. The TV sector is one of those growth areas, and the big news there has been the growth of cable along with foreign monies flowing into local TV webs

The first monies to flow into local webs by way of a cable operation in Chile started in May 1987. The operation was originally called Mundo cable but was renamed Metropolis in 1993. It was largely owned by Argentine interests, and in 1994 it reached 25,000 homes in Santiago, and offered 24 channels. Its major competitor was Intercom, owned by the powerful Chilean publishing group, Mercurio. Intercom's history in Chile is a troubled one. In the early 1980s U.S. consultants advised Intercom to jumpstart the pay-TV industry in Chile by wiring the affluent districts of Santiago. However, since the wealthier sectors of society had other options for their leisure time, the number of original subscribers was low. (More recent experiences show that middle-class neighborhoods are a better target area). Another sign of the difficulty, and risk, of starting a pay-TV industry

in Chile was that the Intercom installations were destroyed by terrorist bombs in 1989.

After its rocky start, Intercom began its service with two channels. By 1993 it had 16, including HBO-Olé, CNN International, and ESPN. By 1994 it had 18,000 subscribers and about 24 channels, including the Discovery Channel, MTV Latino, and Gems. A third cable system, Cable Hogar, started in 1994 and hoped to reach 10,000 subscribers by year's end. There was also an over-the-air PPV station owned by the Luksic group, which had about 5,000 subscribers and 8 channels. In 1994, Chilean cable was limited mostly to Santiago although 109 licenses had been granted by the government and sites ranged from the northern town of Arica to the southern city of Punta Arenas. Twenty systems operated in the country at this time, and before year's end 60 more were expected to go on line.

Despite the early struggles of the pay-TV industry in Chile, the country is a comparative oasis when it comes to doing business in Latin America. As with all oases though, part of the beauty from afar is a mirage. Chile is known as a low-risk environment, and in the following subsections, I argue that for the pay-TV industry, Chile has a low political risk factor and a moderate economic risk factor. Some may argue that the economic risk is also low, and it is in comparison to other developing markets, but not in comparison with mature markets such as the United States.

Political Risk

Chile is a comparatively stable country with free-market ideology, established political institutions, and numerous international links through trade agreements and treaties. I contend that political risk for the Chilean pay-TV market is low because, from a managerial perspective, political risk should be viewed as company-specific rather than country-specific. All companies in the same country will not be affected by factors such as political instability in the same way. The challenge is to understand the sources and types of risk, as well as how they can be handled so that the firm is affected in as positive a manner. The political risks that the pay-TV industry has the potential to face in Chile are regulation due to, or possibly to avoid, a market shakeout. Other possible regulatory measures could affect content, but a strategic alliance with a local or regional company can allay many of these problems.

Chile is often taken by admirers and critics alike to be a model of neoliberal modernization in Latin America in the late twentieth century. It was the first

country in the region to embrace economic neoliberalism after the 1973 coup that brought down the socialist coalition government of Salvador Allende, and this embrace was also the most thoroughgoing in light of Chile's lack of heterodox detours that characterized many other Latin American countries throughout the 1980s. In point of fact, Chile's adherence to the classical economic development doctrine of liberalization and free trade has been so successful in generating high rates of export-led growth that its recent economic performance has been favorably compared to Hong Kong, South Korea, Singapore and Taiwan.

However, the Chilean experience in neoliberalism is also distinguished from those of other Latin American countries in that its economic reforms were initiated, carried out, and consolidated largely prior to its transition from the Pinochet military regime. The Chilean case thus contradicts much thinking that envisions a necessary and causal link between political and economic liberalization.

Regardless of the pathway to reform, Chilean markets are more open than ever. (A trade deal with Mercosur was just signed as was a free-trade deal with Canada). However, in the short-term, congressional elections have been set for December 1997, and slower growth and tight fiscal policies are likely to translate into somewhat weaker support for the ruling Concertación coalition (despite their strong performance in the municipal elections of October 1996, when its share of the vote increased to 55.6 percent from 1992's 52.1 percent). The dominant Partido Demócrata Cristiano (PDC) saw its support lessen to the benefit of its left wing coalition parties. Despite these signs of tension within the group, there are also signs of internal problems in the main opposition group, Unión por Chile. The tensions in both will probably be repressed until 1998, when the prospect of presidential elections could lead to serious divisions (and possible high profits for news networks covering the melee). Due to constitutional changes allowing the government to appoint three unelected senators, the ruling coalition should win control of the Senate, despite its level of support falling in the house. Political risk is not in question, and the risk to the pay-TV industry as stated earlier is low.

Economic Risk

Latin Americans are embracing pay-TV and its myriad of entertainment options, and businesses are, and can still, reap the awards. But, as was discussed earlier the anticipated windfall may be cut short by a market shakeout, one that the stability and predictability of both the economy and government policy in Chile may help firms to weather better than in other,

more volatile markets.

Investors in Chile can still count on the best business climate in Latin America, despite a *Variety* of irritating controls. Growth remains the most rapid of any major economy in the region, even during a slowdown period. Yet, pay-TV companies looking to Chile will face two large challenges in 1997: the appreciating peso, and the intense competition of certain sectors such as telecommunications, retail and banking. The bearing down on inflation by the government will reduce import prices, but it will also make exporters less competitive, which could effect how consumers decide to spend their leisure money. Intense competition will limit the growth of profits, even as revenues rise, but trade integration will continue and that should bolster the economy for the years to come.

The economic risk for the pay-TV industry is moderate. The biggest factor keeping the risk from being rated low is the small relative size of the market and the definite possibility of a pan-regional shakeout. In this subsection I offer a general overview of the economy pay-TV firms will face in Chile. Issues such as GDP, investment growth, FDI, Central Bank policies, government spending, inflation and currency issues are covered.

Chile's GDP should grow by a respectable 5.2 percent in 1997. The slowdown from last year's 6.7 percent reflects a tighter monetary policy to correct signs of overheating, lower consumer demand, and slower export growth due to a stronger exchange rate. However, looser policy in the second half of 1997, along with strong growth in domestic investment, will have the economy growing at 6 percent in 1998. The Economist Intelligence Unit predicts that the GDP in US\$ billion (based on current dollars), will grow from \$71.7 billion in 1996 to \$105.5 billion in 2000.

Investment growth slowed abruptly in 1996. On an annual basis, overall investment in the second quarter was up by only 0.8 percent, compared with a 14.9 percent rise in the first quarter. The drop in investment from small- and medium-sized businesses was especially marked, as the cost of working capital rose in line with higher interest rates. A loosening of monetary policy in the second half of 1997 should reverse this process, which should lead to a recovery of investment. Chilean banks could be headed for tough times, although loan growth has slowed to 11.7 percent in 1996 from 18 percent in 1995, and consumer credit increased by 34 percent. A changing risk profile could make the institutions more vulnerable to the country's enforced and relative economic slowdown (including rising unemployment).

FDI was the strongest investment element in 1996, and will be again in 1997. Total new foreign investment exceeded \$6 billion dollars in 1996, a 42 percent jump from 1995. Mining, a key indicator for the overall economy, will continue to attract the most investment in Chile, but telecommunications will receive attention as well. Direct foreign investment into Chile rose in 1995, but falling portfolio investment offset the increase, bringing the overall inflow to \$4.3 billion, a 5.5 percent drop over 1994. Direct investment increased by 20 percent, to \$3.02 billion. The mining industry received 57 percent of this; the service industry received 26 percent; construction received 2 percent; other industries received 10 percent. Portfolio investment fell to \$886 million from \$1.64 billion in 1994.

In November of 1996, Chilean officials fine-tuned reserve requirements, the *encaje*, on foreign investment in order to smooth the passage of a foreign trade deal with Canada. Foreign direct investors will benefit from this move. Companies, mostly financial institutions, that brought capital into the country to play financial markets, or develop cable television markets will not benefit.

In 1991 the Central Bank imposed its much hated policy to help ward off inflows of "hot capital", or foreign portfolio investment, because it was thought to be dangerous to stability. Thirty percent of all investment, direct or indirect, has to be placed in a one-year, non-interest bearing account with the Central Bank. Portfolio investors have to keep dreaming for an end to the controls; direct investors will no longer have to abide by the law. Foreign investors are favored by the new measures because they differentiate between a "productive" and a "financial" investment. Productive projects will be exempt from the *encaje* on direct equity investments, although any debt portion of the investment will not be exempt.

Despite a fiscal surplus, government spending is coming under downward pressure. At the close of 1996, President Frei ordered that each ministry cut its budgeted spending by 1.5 percent, which should lead to a \$75 million savings next year. Education and transport infrastructure should suffer austerity the least, which should help the pay-TV industry by increasing possible service routes, and increasing potential viewership.

Pay-TV firms need to keep a close eye on inflation, as it will affect two key aspects of business: the cost of their service, and the ability of the consumer to pay for that service. The appreciation of the peso is a sign that inflation is

a main target of the government for 1997, as are the tightening of monetary policy and the cuts in fiscal spending. Progress will be slow, however, given the continued indexation of much of the economy.

The tightening of government monetary policy has hurt credit growth. Short term interest rates (measured by the Interbank rate) were allowed to fall by the Central Bank from a real 7.5 percent to 7.25 percent at the end of January 1997. Further drops will depend on the successful handling of inflation. On 21 January 1997, the basket of currencies used to set the reference point of Chile's exchange-rate band changed from 10 percent to 12.5 percent on either side. The dollar now makes up 80 percent of the basket (as opposed to 45 percent before). The effect was to provoke an immediate nominal appreciation to Ps421: \$1, based on a Ps457: \$1 central peg. The currency could appreciate to as much as Ps400: \$1 before intervention is started to weaken the peso. The reasoning behind this is the reduction of inflationary pressure.

The Chilean government believed business was expecting too much in 1996, and in an effort to reel in growth and reduce the possibility for a burst of inflation, the government hiked interest rates, targeting a GDP growth of 6 percent and year in inflation of 6.5 percent. GDP expanded by 8.3 percent in 1995, exactly the same as consumer prices. The tighter policy stance of 1996 was meant to nip inflation in the bud, restraining the inflationary expectations of business and sensitive investors. The government did not believe that Chile could sustain 1995's high growth rate without spiking inflation.

Infrastructure, Education, Labor and Competition Policy

Issues regarding infrastructure, education, labor, and competition policy are related to political and economic risk, but their relative importance to the pay-TV industry makes it necessary to discuss each to a larger degree.

Infrastructure development is key to the success of the pay-TV industry because the programmers rely on telecommunications (cabling and satellite) infrastructure to reach operators, and operators rely on those same methods, as well as roads, to service the consumer. For geographic reasons, the Chilean market is divided between cable and satellite delivery. Chile has an area of 292, 135 sq. miles. It occupies the western coast of southern South America, and neighbors Peru to the North; Bolivia to the Northeast; Argentina to the East. The topography is diverse, and often wild. The Andes Mountains rise up from the eastern border and include some of the world's

highest peaks. To the West is 2,650 miles of Pacific coastline. The Atacama Desert is in the North. The center of the country contains its agricultural regions, and in the South there are forests and grazing lands. The capital, Santiago, with a population of 4.6 million holds the bulk of the country's population. The pay-TV market is split by the diversity of this terrain because some residents living high in the Andes or in the Atacama do not, and cannot without high expense, have cable television. They can however, have DTH-TV, thus the market while divided, is actually made larger due to new technologies.

There are an estimated 1.5 million telephones, or one per 9.1 persons in Chile. The current telephone system is modern, based on extensive microwave radio relay facilities. Domestically, there are extensive microwave radio relay links, and a domestic satellite system with 3 earth stations. Internationally there are two Intelstat (Atlantic Ocean) satellite earth stations. This is significant to the pay-TV industry because as was mentioned earlier it is possible that in the coming years both traditional

telecommunications firms and pay-TV firms will be in competition with each other because pay-TV firms will be able to offer telephone services, and telecommunications firms will be able to offer pay-TV services. This would be done by modifying existing cable conditions. (Internet services could be offered as well).

Other media which compete with pay-TV for consumers are radio and broadcast television. In Chile there are an estimated 159 AM radio broadcast stations, zero FM stations, 11 shortwave stations, and 131 television broadcast stations. There is roughly one radio per 3.2 persons. However, radio is mainly used by lower classes for entertainment, and broadcast channels tend to not have the *Variety* of programs that cable operators would offer the targeted middle class.

By conservative estimates, \$60 billion dollars annually will be required to fund Latin America's infrastructure needs through the end of the decade. Of the total, \$10 billion will be required for telecommunications, \$24 billion for power projects, and \$14 billion for transportation. Each of the

three areas are important to the pay-TV industry because telecommunications covers the infrastructure necessary to deliver the product, power to view the product, and transportation to service the product.

However, project financing is evolving painfully slowly in Latin America. Investors are becoming bolder as they become familiar with the risk, but there is little chance that the stream of funds will become a river within the next few years due to the limitations of the commercial banking sector. Latin America's huge infrastructure needs will remain largely unmet in the near future because of the lack of available financing.

The biggest problem for Latin America is the side effects of the 1980s debt crisis. Commercial banks in developed countries are still required by their regulators to make large reserve provisions for any unguaranteed non-investment grade Latin American exposure. Some progress is being made however. Investors are giving up project risk guarantees and taking uncovered positions. Some Latin American governments are assuming >more risks.

Chile has no shortage of demand for infrastructure projects. Its near-term project finance needs (uncompleted deals suitable for project finance) are US\$9.2 billion. One problem is that the infrastructure bonanza promised by Chile's public works ministry, a total of US\$11 billion to the year 2000, remains a mirage on the horizon. Only \$400 million of toll road concessions, for example, were awarded as of fourth quarter 1996, far below the government's \$1.5 billion goal for the year. Part of this problem is the usual bureaucratic foot-dragging. A bigger challenge is arranging the financing for the projects. The local pool of funding is too shallow, and despite Chile's investment grade rating, foreign investors are not comfortable with the inherent long-term commitments. However, all is not dark. One group of investors, pension funds, may be more willing to take on sovereign exposure at home, as well as nearby countries. In Chile, pension funds are a

viable component of financing for long-term domestic projects, such as satellite launches and fiber optic cabling, as well as roads to potential markets. As pension funds grow, cross-border investments may become commonplace, especially in the Andean and the Mercosur market.

Chile boasts a healthy capital market, with about US\$1 billion available for investment. But the traditional investors in these projects, the aforementioned pension funds, and the insurance companies, operate under restrictions that keep most deals out of reach-even the construction phase is considered to risky.

Despite pension funds and an ever-growing list of finance sources for

infrastructure projects, developers still rely significantly on the participation of multilaterals such as the International Finance Corporation (IFC), the World Bank's private sector affiliate. An alternative is to seek foreign funds, but these too are hampered by restrictions from the Central Bank. (The most notorious of these is the 30 percent one-year non-interest bearing reserve on foreign investment funds entering the country-costs that would apply to any further refinancing of a project.) The biggest barrier, however is the currency exchange risk. Due to the long-term nature of infrastructure projects, there are no instruments that will hedge a 15-20 year currency exposure.

The Frei administration is taking steps to improve funding for Chilean infrastructure projects. Cash flow may now be used as debt collateral; banks may invest 15 percent (up from 10 percent) of their assets in these projects; and projects may be evaluated faster. But, fears of a second "Tequilla" (or in this case "Pisco") shock that followed the Mexico peso crisis of 1994, and memories of Chile's own crisis in the early 1980s continues to dissuade officials from any aggressive liberalization of Chile's strict securities regulations.

Infrastructure needs in Chile may plague the speed at which the pay-TV market in Chile blossoms, but there are other signs that in the

long-term, Chile will be a strong market. For instance, Chile has become a pioneer in Latin America by tackling one of economic development's most difficult problems-education. In June 1996, Chile announced a major initiative to address the country's educational system by setting goals to increase productivity, reduce inequality, and assure the sustainability of Chile's famed economic miracle. The education reform project calls for increased teacher accountability and an end to two shifts in public schools; instruction time will also increase by one-third. Once the reform is finished, Chilean schoolchildren will have as many instruction hours as their counterparts in East Asia. The reform will affect 9,000 public schools at a cost of about 3 percent of current government expenditures. What does this mean for the pay-TV industry? Plenty. The pay-TV industry needs an educated (and thus, often more wealthy) populace to beam its programming too. Chile's reforms in the long-term will increase viewership, and possibly competition. A well-educated workforce will also provide better service and could create a bigger market for original productions which could increase market share for networks looking to provide operators with exclusive programming.

Another feather for Chile's cap is its workforce. Any firm looking to enter

the pay TV business must consider labor concerns for two reasons. The first is the firm will need employees, the second is that they need to enter a country where workers can afford their service. Chile succeeds on both counts. The minimum monthly salary for Chilean workers is Ps 58,900 (Ps 407: US\$1); adjusted on an ad hoc basis. (Large foreign firms pay more). Chile's worker wages and productivity are up, which raises the odds that the number of consumers with the requisite amount of expendable income to support a pay-TV market is increasing. The average hourly wage index rose by over 12 percent in December 1995, versus a year earlier. However, consumer prices increased by over 8 percent, cutting the real wage increase to just over 4 percent. The highest rises were in services (16 percent), construction (16 percent), and commerce (13 percent). Labor productivity grew by a record +7 percent in 1995, with the largest jumps in agriculture

(11 percent) and commerce (10 percent). However, a fall of almost 2 percent was registered in financial services. Labor productivity for 1970-1993 was strong. The annual percentage change for 1970-80 was 0.5 percent, for 1980-90, -0.2 percent, for 1990-3, 3.8 percent.

Another labor issue to consider along with wages is how many people are being paid those wages. In 1990 the average urban unemployment for Chile was 6.5 percent. The 1995 estimated showed that this number had diminished to an estimated 5.6 percent. Unemployment fell to the lowest level it has been in 25 years in 1996, 6.4 percent. However, tighter government policies have slowed the rate of wage growth. For the first time since 1996, wage rises were under 10 percent in the year to December. The slackening of real wage growth will boost the profitability of exporters, but consumer demand will suffer. It is possible that the sporadic outbreaks

of unrest that plagued the public sector and mining unions in 1996 will recur in 1997. Although labor-force growth continues to exceed population growth, the gap between the two is decreasing. In Chile, the average annual growth of the labor force (1991-2000, %) is 1.8. The average annual population change (1990-95, %) is 1.6. The percentage of the population under 15 years (1995 figure) was 29.5.

A possible direct problem for operators, and indirect for programmers is the possibility of growing labor conflict. If strikes in the pay-TV service industry were to occur operators would be directly affected, and programmers, because the operators they sell to are in trouble could be indirectly affected. The chance that strikes will occur is slim, but must be considered. For ten years, Chile's unions have been dominated by compliant Christian Democrats. However, elections in the *Central Unitaria de*

Trabajadores (CUT), Chile's largest grouping of labor unions, will usher in hard-line former communists and socialists. Chile has set the pace in

Latin American reforms for two decades, and the radical deregulation of the labor market was one of the pacesetters. Now, however, the knot in the tug-of-war rope may be nearing labor's side. Chile's sustained economic growth is making it ever harder to deny requests to alleviate austerity measures by restoring some union privileges. There have been signs of mild labor activity. The number of workers involved in strikes rose from nearly 16,000 to nearly 25,000 in 1994-1995, although the number of stoppages fell slightly. However, the possibility remains that activity will increase if workers feel that their rights to bargain collectively and strike are not protected.

As regards the possibility of a future shakeout of the market, pay-TV firms must also focus on competition policy in Chile. Chile works hard to establish itself as a bastion of free trade and open markets in Latin America. However, in the regulation of monopolies it comes up lacking. In many sectors businesses rely on established loopholes and the indecision of the country's anti-monopoly commissions to merge or team together as they please. The end result is that consumers lose out. However, the

situation also generates risk for companies. This is not because the current regulatory framework creates a lack of predictability, rather it is because future reforms may move towards tougher competition laws with potentially adverse implications for the profitability of established firms. This is only likely in the medium to long term, but it has relevance to the cable television industry in that firms tend to start joint ventures, or try to corner a particular aspect of the market (premium channels, pay-per-view, low-income sectors) and may, in the future find themselves backed into a corner with an expensive fight on their hands. At present however, there is little impetus for change. The business community and the government are happy, although cases are developing (in the forestry sector, for instance) which may draw attention to the system's shortcomings.

The bulk of Chile's anti-monopoly legislation was put into place just after Pinochet took power in December 1973. Most of its language is fuzzy, and thus loopholes exist which permit a number of monopolies to exist. The legislation calls the following illegal:

- Price-fixing; Production or distribution quotas or zones;
- Establishing exclusive agencies for marketing specific products;

- Obstructing the labor market.

Compliance is monitored by an independent watchdog agency, Fiscalía, which provides two anti-monopoly commission to hear cases: the Prevention Commission and the Resolution commission. In the first instance, cases the Prevention Commission investigates and adjudicates. Appeals go to the Resolution Commission. The final level of recourse is Chile's Supreme Court. The complex structure is a lawyer's delight.

The composition of the anti-monopoly agencies is part of the problem. Membership is determined by law, which requires that a certain number of lawyers and university deans serve on each commission. Business experience is not a prerequisite, and member are volunteers with no technical support, which can lead to poorly arrived at decisions. The underlying problem is the apparent lack of a strong desire for change. Businesses know what legal hoops (or loopholes) they must leap through and are apparently not interested in a more stringent process (the hoops may be smaller and harder to jump through). Also, the government is not disposed at present to pick a battle with corporate interests-the bulk of right-wing opposition.

Programming and Advertising Issues

Because we are concerned with programming for a entry market, that is to say with programming for Chile which should be successful in other regions of Latin America, it is important to note the most successful programming in Latin America thus far has been: sports broadcasting, music television, children's programming, cartoons, adult programming, news and documentaries, movies and science fiction, and telenovelas. A description of each type of programming with an analysis of its potential in Chile follows.

Sports broadcasting is an excellent program choice for a channel looking to move from the lead market stage to the pan-regional stage. The history, and success, of sports broadcasting has shown that launching a pan-regional channel does not mean much if local needs are not considered . An example of this is one of the most widely distributed pay-TV networks in Latin America, ESPN. The network entered Latin America in 1989 as a pan-regional service transmitted simultaneously in English, Spanish, and Portuguese. Local feeds were launched soon thereafter, and an entirely separate channel was set up for Brazil. There are now 8 million subscribers to ESPN in Latin America, up 20 percent over last year. Ad sales have been

equally brisk as the pan-regional idea is making its way to ad agencies who realize that pan-regional sports networks offer an excellent opportunity to address a broad range of customers. A sports broadcasting network for Chile could focus on sports such as soccer and snow-skiing that are prevalent and popular in the country. It could also utilize the competitive nature of Chile and its neighboring countries by highlighting sports events where the teams come from opposing countries.

Music television is another successful programming format that should be considered for the Chilean market. MTV, the industry leader in music programming, has two different programming blocks in Latin America, one for the Mercosur market, and another for Mexico and Central America. The service features video jockeys from Chile, Argentina, and Mexico who showcase videos from a mixture of local, regional, and international bands. A competing music television station for Chile could focus more on local and regional bands, giving the network an exclusivity factor.

Cable marketers looking to go international know that cute and noncontroversial children's programming, is a successful path. The Chilean market is no different. However, such a strategy is not infallible, controversy can stem from what a large section of America would agree is entirely innocent. An example is Porky Pig. In the United States he is a charmer; in many parts of Muslim Asia he is an anathema. Consequently, Turner's Cartoon Network has pulled him from that region of the world. Chile has its own ghosts and cultural norms, and these must both be known and treated with care. The reason for the caution is simple: Like many emerging markets, the population of both Chile and its fellow Latin American countries is young. More than 30 percent of the cable market in Latin America is under the age of 15. A network looking to break into the Chilean market would be smart to invest in local production of popular Chilean children's stories and issues rather than Spanish dubbed reruns of U. S. programs. Cartoons are related to children's programming, but are actually aimed at kids of all ages. If the success of Turner Broadcasting's Cartoon Network is a sign, cartoons could be a boom market for Chile. The Cartoon Network has 7 million total viewers in Latin America, with a 20 percent to 30 percent annual growth in terms of ad sales.

Adult-oriented programming is a supersensitive genre, especially in a strong Catholic country, but that does not deter programmers from formulating plans to go beyond U.S. borders. Adult networks such as Playboy and the Spice network have seen success in Latin America. If properly controlled (available as a monthly subscription or on a PPV basis) other adult programming, specifically programming aimed at an audience which

reflects the Chilean population, could succeed.

News and documentaries networks are among the most prevalent and successful programmers in Latin America. For Chile, a news or documentary network that focused solely on Chilean news (or regional or global news from a Chilean perspective) could gain an exclusivity factor that could bring success. Similar channels could then be started in the pan-regional area.

The most popular avenue for movies and science fiction are the premium channels beamed in from U.S. networks after they have been dubbed into Spanish or Portuguese. For Chile two options exist. Create exclusivity among operators by creating a premium channel that is only available through one operator, or to create a channel which highlights Chilean and other Latin American countries cinema.

Telenovelas are the biggest source of original production revenues for Latin America. Chile's university run stations and the national governments stations compete with each other on a weekly basis for the original production telenovela market. The potential exists for a pay TV network to provide Chile with telenovelas from both Chile and other Latin American countries.

Despite the myriad of programming option, cable programmers looking longingly at the Chilean cable television market will have to know what is happening there before they go. Audiences scrutinize what is shown to them, and especially, what they allow to be shown to their families. Adult fare (a potential big moneymaker) can be taboo in many places. Even news, games, religious programming and cartoons have to be edited with cultural sensitivity in mind.

Parents are not the only group for programmers and operators to fear. Chile's FCC equivalent, the Consejo Nacional de Television (CNT) decided in October of 1995 to regulate the content of pay TV. Prior to this time it had lacked the funds to do so. The Supreme Court has even debated whether the CNT, which regulates free TV, has the right to control cable.

A debate was sparked when Latin American cable network HBO Ole aired "Basic Instinct" in 1994. Cable subscribers all over Chile tuned in, only to be met by the following notice: "Following regulations and a suggestion by the Cable TV Assn., the program for this timeslot has been suspended." The reason: in 1994 films classified for adult audiences (over 18) may be shown

only after 10 p.m. whether on broadcast or cable. The CNT considered penalties against such networks as HBO Ole (for the Bruce Willis film, "Striking Distance"); Turner's TNT (for Francis Ford Coppola's "Rumble Fish"); MTV Latino (for Aerosmith's video for "Livin' on the Edge).

Under CNT's plan, staffer's spend a week viewing film, children's and music channels from one Santiago system and one provincial system per month. Their findings go to a supervisor who affirm if violations exist and then file formal reports to the CNT board. Within five days, these regulators decide if charges will be brought. Charges can include pornographic content or excessive violence, but the most common violation is the ten o'clock rule. The problem is deciding what is adult content.

If a charge is leveled, the cable operators may present a defense. If this fails a fine, suspension, or annulment of the operator's license can be levied. The accused then have the right to appeal in court-all the way to the supreme court. On October 31, 1995 five Christian Democrat Congressman presented a writ to the Court of Appeals, claiming the CNT was interfering with constitutional rights. In January of 1996 this was thrown out because the court felt the CNT was responsible for regulating all television. This was appealed to the Supreme Court.

CONCLUSION

The future of the pay-TV industry in Latin America is both bright and volatile. As this paper has shown, country markets are becoming saturated and a market shakeout and subsequent restructuring are expected. U.S. firms would be wise to recognize the differences between markets in individual Latin American countries such as Chile, and the rest of the pan-regional market. As this paper has also shown, a firm that is focused on the political, economic and cultural risks of Chile will find a comparatively secure market from which to get a headstart on the competition that is focused largely on the more saturated markets of Mexico, Brazil and Argentina. Opportunities exists in Chile, both to grow by expanding programming options and exclusivity, and to stay secure by investing in a strategic alliance and solid market in order to ride the storm of a pan-regional shakeout.

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